Highlights and Analysis of the Governor's May Revision of the 2006-07 Budget

May 15, 2006
SENATE REPUBLICAN FISCAL OFFICE

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Budget Briefs

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Executive Summary

Revenues and Expenditures Both Up

The Governor's May Revision for 2006-07 proposes total state spending of $131.1 billion, $101 billion of which is General Fund. Since January, General Fund revenues are reportedly up $4.8 billion in 2005-06, and are estimated to increase an additional $2.7 billion in 2006-07, for a total $7.5 billion increase over the two years. The May Revision spends $5.5 billion more than the Governors Budget as proposed in January, $3.1 billion of which is General Fund.

While the total proposed General Fund budget carries a $2.2 billion reserve in 2006-07, absent a $9.4 billion carryover from the prior year, the May Revision would be short about $7.1 billion General Fund. Of this amount, over $3 billion is proposed by the Administration for debt relief and paying down future obligations, with an additional $1.6 billion being used on one-time expenditures, a number of which will be highlighted later. The remaining $2.5 billion operating deficit is for ongoing General Fund program expenditures.

Much of this document will highlight the differences between the Governor's Budget proposal in January and the subsequent May Revision. However, it is also important to keep in mind the year-over-year and multi-year implications associated with the 2006-07 budget proposed in the May Revision.

Indeed total General Fund spending (one-time and ongoing) is ***up $11 billion from the level approved in the 2005 Budget Act***, a 12.2-percent year-over-year increase. Year-over-year General Fund revenues are projected to be up $9.4 billion (11.1 percent) when compared to revenues estimated for the 2005 Budget Act.

Table 1 below highlights the programmatic budget changes in the May Revision as compared to the 2005 Budget Act.

Table 1

General Fund Expenditures by Agency (Dollars in Millions)	2005 Budget Act	2006-07 May Revise	Change	%
Legislative, Judicial, Executive	$3,057	$3,431	$374	12.2%
State and Consumer Services	562	571	9	1.6%
Business, Transportation & Housing	1,702	2,381	679	39.9%
Resources	1,356	1,742	386	28.5%
Environmental Protection	79	75	-4	-5.1%
Health and Human Services	27,115	29,141	2,026	7.5%
Corrections and Rehabilitation	7,422	8,661	1,239	16.7%
K-12 Education	36,583	40,541	3,958	10.8%
Higher Education	10,217	11,279	1,062	10.4%
Labor and Workforce Development	88	97	9	10.2%
General Government	1,845	3,066	1,221	66.2%
Total	**$90,026**	**$100,985**	**$10,959**	**12.2%**

A considerable portion of these increases in expenditures are the result of formula-driven programs. However, there are numerous budget policy choices represented in these expenditure increases as well.

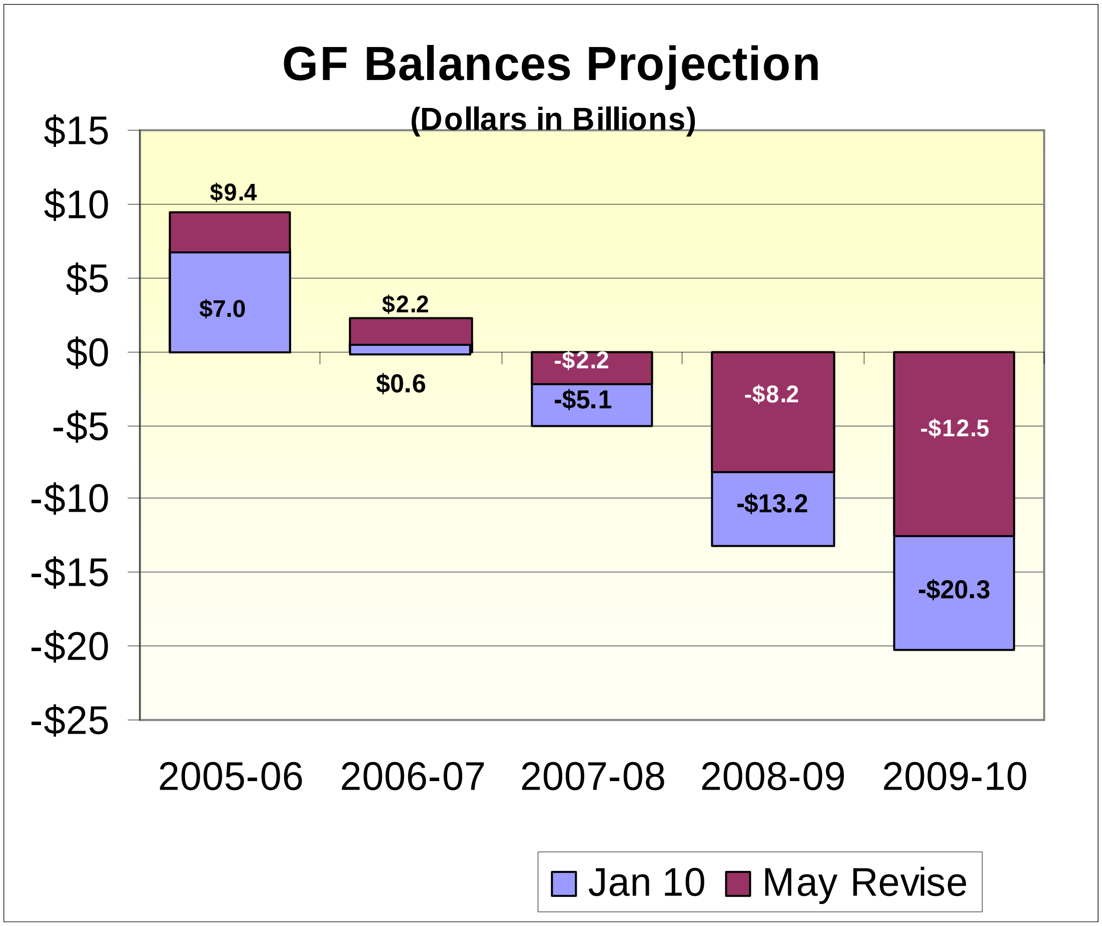
The substantial increases in General Fund spending highlighted above have been largely possible due to significant borrowing in prior years, as well as significant increases in Personal Income Tax (PIT) revenues highlighted below. As is evident in Table 2, these revenues (which can be volatile) have grown $7.6 billion since the 2005 Budget Act, and they represent 81 percent of the total $9.4 billion in General Fund growth since 2005.

Table 2

General Fund Revenues (Dollars in millions)	2005 Budget Act	May Revision	Difference
Personal Income Tax	$43,231	$50,877	$7,646
Sales & Use Tax	26,951	28,103	1,152
Corporation Tax	8,822	10,507	1,685
Other Revenues and Transfers	5,467	4,379	-1,088
Total	**$84,471**	**$93,866**	**$9,395**

The table below highlights changes to multi-year General Fund balances between the Governor's Budget proposed in January and the May Revision. The outlook for the current and budget year has improved considerably, and out-year General Fund deficiencies have decreased. Nonetheless, despite the significant increases in General Fund revenues, the Department of Finance is anticipating a $2.2 billion General Fund shortfall in 2007-08, growing to a $12.5 billion shortfall by 2009-10. ***By any measure, those are still staggering out-year shortfalls*.**

Table 3



How Does California Compare to Other States?

According to the National Conference of State Legislatures, California is the only state besides Connecticut (as well as the Commonwealth of Puerto Rico) known to have issued Economic Recovery Bonds to pay for operating expenses. And in the case of Connecticut, the amount of ERB funding used was a much smaller portion of their budget both in total dollars and as a percent of their budget when compared to California. (Note: Connecticut is also planning to prepay their ERB payments in 2006-07, in their case for both 2007-08 and 2008-09, depositing their remaining estimated budget surplus into their rainy day fund.)

Some of the other states in the nation that are unhampered by debt from ongoing expenditures are using their surpluses to reduce unfunded pension liabilities (Washington for example). Others, such as Oregon, are ***actually planning to RETURN significant portions*** of their revenues to the taxpayers! (Imagine that!)

Still No Structural Reforms

Let's be clear, the improved fiscal circumstances of the state are a result of windfall revenues and significant borrowing in prior years, versus the fruits of significant spending reductions or meaningful budget reforms. The table below further highlights the General Fund component of this fact, comparing the operating deficit for 2006 as predicted in the 2003 audit completed by the Administration, to the operating deficit in the May Revision. As the table indicates, revenues have played an overwhelming role in reducing the inherited operating deficit from $16.5 billion to $7.1 billion, but have still been offset by continued increases in General Fund expenditures.

This persistent disparity points to a lack of budgetary reforms in programs that drive perpetual funding increases and that are in desperate need of statutory and constitutional reform, as has been proposed by the Administration and others on numerous occasions. Had earlier efforts to rein in spending been successful, or had the Administration been provided with mid-year expenditure reduction authority, the differences between revenues and expenditures would have significantly diminished.

Table 4

2006 Budget Comparison
(Dollars in billions)

Category	2003 Audit Estimate of 06	2006-07 May Revision	Difference
General Fund Revenues	$83.2	$94.3	$11.1
General Fund Expenditures	-99.7	-100.9	-1.2
Budget Stabilization Account		-.5	-.5
Gross Operating Deficit	**-$16.5**	**-$7.1**	**9.4**

Bringing it All Together: Our "Fair and Balanced" Assessment.

The May Revision makes some measurable improvements to the Governor's Budget proposed in January, and further reduces some outstanding budgetary borrowing. It leaves considerable budget balancing work to future endeavors, relying upon carryover balances to continue expenditures at a rate greater than General Fund revenues will support. It does not propose significant programmatic reforms or reductions, and General Fund expenditures still rise significantly year-over-year beyond the level of General Fund revenue growth.

As is evident in the tables above, and further highlighted in the pages to follow, notions of major "cuts" in expenditures that some may claim have occurred over the past several years simply do not ring true when General Fund spending is viewed in the aggregate. In fact, it's quite the contrary.

The likely volatility of the revenues used to buoy some current and budget year expenditures warrant considerable caution, and should not be relied upon to fund ongoing programs.

Finally, the large influx of one-time revenue provides more opportunity to pay down existing debt than has been proposed to date.

General Fund Revenue Estimates

General Fund Revenue Forecast. General Fund revenues are expected to be above the Governor's January Budget by $4.8 billion in 2005-06 and above the Governor's Budget by $2.7 billion in 2006-07. Substantially stronger personal income tax payments and corporation tax growth account for the bulk of this growth. The Administration also indicates that there is concern that a large portion of this growth is one-time in nature. They estimate that approximately $1.7 billion will be permanent ongoing growth.

Personal Income Tax. The personal income tax forecast increased by $3.9 billion in 2005-06 to $49.4 billion and by $2.2 billion in 2006-07 to $50.9 billion. General Fund payments received in April and the first days of May were $3.7 billion over the January forecast, which suggests that taxable income was stronger than expected for the year. The 2003 tax data indicate higher income and liability growth for taxpayers with gross income over $100,000. Capital gains income growth in 2005 was 32 percent; which is in addition to the 60-percent growth in 2004. The Administration expects that capital gains income will stabilize in 2006.

Sales & Use Tax. The sales and use tax forecast has been increased by $27 million in the current year to $27.2 billion, and decreased by $192 million in the budget year to $28.1 billion. Included in this forecast is a decision to transfer $200 million that would otherwise have been deposited in the General Fund and $344 million in spillover revenue that would otherwise have been transferred to the PTA to a special fund to repay transportation debt.

Corporation Tax. The corporation tax forecast has increased by approximately $735 million in 2005-06 to $10.4 billion, and increased by approximately $483 million in 2006-07, to $10.5 billion. This improvement is attributable to stronger corporate profits and enhanced compliance experienced in 2005 and projected for the forecast period.

Tobacco Securitization Bonds

Refunding/Refinancing 2003A Bond Series. The May Revision proposes legislation to authorize the refinancing of the Golden State Tobacco Securitization Corporation's 2003A bonds. The Administration indicates that restructuring the utilization of the tobacco settlement payments will generate proceeds of $900 million for the state without jeopardizing payments to the existing bondholders.

Simply put, the state will (1) refund the 2003A bond series, (2) develop a new issuance that will include a credit enhancement to add value to the instrument, and (3) reissue the series at a lower cost. Motivated by the "buy low, sell high" mantra, this change will generate approximately $900 million, which will be deposited in a dedicated special fund to address a Proposition 98 funding issue.

Education

Proposition 98 funding grows by $2.8 billion over two years. Current year revenues have increased significantly since January, pushing the 2005-06 Proposition 98 minimum guarantee of funding for education up by about $2 billion. This increase will carry forward into 2006-07, but because the Governor's January budget already included a substantial overappropriation, only about $800 million more is needed to fund the 2006-07 minimum guarantee.

The table below details the changes in Proposition 98 between the January Governor's Budget and the May Revision, as well as proposed K-12 per-pupil expenditures, both from Proposition 98 and from all fund sources (including federal funds, lottery funds, etc).

Table 5

Proposition 98 Total and Per-Pupil Funding Grow Substantially		
2005-06		
(Dollars in billions)	**Jan 10 Budget**	**May Revision**
Proposed Prop 98 Funding	**$50.0**	**$53.3**
General Fund	$36.3	$39.7
Local property taxes	$13.7	$13.7
Minimum guarantee	$49.7	$51.2
Over/underappropriation	$0.3	$2.1
(actual $)		
K-12 Prop 98 per-pupil funding	$7,427	$7,787
K-12 total per-pupil funding	$10,336	$10,749
2006-07		
(Dollars in billions)	**Jan 10 Budget**	**May Revision**
Proposed Prop 98 Funding	**$54.3**	**$55.1**
General Fund	$40.5	$41.3
Local property taxes	$13.9	$13.8
Minimum guarantee	$51.9	$55.1
Over/underappropriation	$2.4	$0.0
(actual $)		
K-12 Prop 98 per-pupil funding	$8,030	$8,244
K-12 total per-pupil funding	$10,996	$11,268

$2 billion for one-time uses. The Governor proposes to spend the new 2005-06 funds for a variety of one-time purposes, as follows:

Table 6

K-12 One-Time Funds Proposed for 2005-06 (Dollars in millions)	
$650	Prior year mandates
$400	Classroom and lab supplies
$250	Standards-aligned instructional materials
$250	Arts and music equipment and supplies
$250	Phyiscal education equipment and supplies
$75	School library block grant
$50	Preschool facilities block grant
$50	Career tech andROC/P equiment & materials
$30	Supplemental instructional materials - English language learners
$10	Re-establish Healthy Start
$33	Other (various)
$2,048	

Notable among these one-time expenditures is the $650 million to retire education mandate debt, which, along with about $300 million provided elsewhere in the education budget, should be enough to extinguish most if not all of that obligation, thus significantly reducing the state's education "credit card" debt.

Also notable, for a less positive reason, is the re-establishment of Proposition 98 funding for Healthy Start, which provides students and their extended families with access to a wide variety of health and social services (transportation, food, recreation, etc). ***Because this program does not serve an educational purpose, the use of Proposition 98 dollars to fund it is questionable*.**

$800 million for ongoing uses. The Governor proposes to spend the new 2006-07 funds as follows:

Table 7

K-12 Ongoing Funds Proposed for 2006-07 (Dollars in millions)	
$355	COLA rises to 5.92%
$200	Counselors for grades 7-12
$100	Increase equalization funding from $200 to $300 million
$102	Eliminate revenue limit deficits
$66	Increase arts/music grants from $100 to $166 million
$50	Expand state preschool for 4 year olds
$38	Increase school meal reimbursement rate
$4	Require dental exam before entering kindergarten
-$63	Other adjustments and proposals
$852	

Notable among these ongoing expenditures is the establishment of a new requirement that children be required to have a dental examination before entering kindergarten. ***This is another non-educational program, for which the use of Proposition 98 dollars is questionable*****.**

Also notable, but for a positive reason, is the Governor's decision ***not*** to use state funds to offset the lack of a COLA on the federally-funded share of special education. ***Doing so would set a dangerous precedent by signaling the state's willingness to use General Fund to hold programs harmless when federal funding falls*****.**

Proposition 98 lawsuit settlement. The May Revision also proposes to settle a lawsuit which charged that the state owed about $3 billion associated with the 2004-05 "oversuspension" of Proposition 98 (beyond the $2 billion agreed to by the education coalition) and its resulting depressive effect on 2005-06 funding. ***The Legislative Analyst and the Department of Finance have both asserted that the law does not require repayment of these funds*****.**

Despite this, the ***Governor has proposed to pay $3 billion over seven years*** to settle the suit, beginning with $300 million in 2007-08, and continuing at $450 million annually thereafter until the $3 billion is fully paid. The use of the funds has not yet been specified.

Missed opportunities. The state owes K-14 schools about $1.4 billion in "settle-up" because it has yet to provide amounts sufficient to satisfy the minimum Proposition 98 guarantees in several past years. Chapter 216, Statutes of 2004 required that the settle-up obligation be paid through a series of $150 million annual appropriations beginning in 2006-07. The Governor began funding these payments early, and the May Revision reduces outstanding settle-up debt to about $1.1 billion. However, by opting to spend $3 billion to settle a lawsuit in which the state may have prevailed, he has missed the opportunity to use these funds to entirely extinguish all of the state's settle-up debt.

In addition, the May Revision misses an opportunity to ***fully equalize*** K-12 revenue limits across the state, providing only $300 million of the roughly $450 to 475 million needed to achieve full equalization (to the 90th percentile).

Three billion dollars in discretionary funding offers schools an opportunity to right themselves. The May Revision increases funding for schools' 2006-07 COLA (5.92 percent -- the highest in 20 years) to over $2.6 billion. These funds, along with over $300 million in deficit-factor reduction and over $300 million in equalization funding can be used by school districts for whatever purposes they deem necessary or desirable. This funding presents a unique opportunity for districts that are burdened with unfunded liabilities to address those liabilities. ***If they decline this opportunity and instead use these funds to expand salaries and benefits, they can be expected to return to Sacramento at some future date to ask the Legislature to fund their liabilities.***

Higher Education

Community Colleges benefit from spike in Proposition 98 funding. The Community Colleges' share of the increased Proposition 98 funding in 2005-06 and 2006-07 is proposed to be spent as follows:

Table 8

CCC's Share of Prop 98 Increases (Dollars in millions)	
2005-06 (One-time)	
$100.0	Prior year mandates
$77.7	Classroom and lab supplies
$40.0	Standards-aligned instructional materials
$23.6	Arts and music equipment and supplies
$15.0	Physical education equipment and supplies
$1.0	Other (various)
$257.3	
2006-07 (Ongoing)	
$29.5	Deferred maintenance / instructional materials
$24.0	Matriculation
$15.0	Economic development
$10.0	High school exit exam remediation
$4.0	Mandates
$5.3	Other (various)
$87.8	

In addition, the May Revision proposes to provide $22.3 million from the Proposition 98 Reversion Account for a one-time general purpose block grant.

The Colleges' share of Proposition 98 funding is expected to be 10.55 percent in 2005-06 and 10.7 percent in 2007-08.

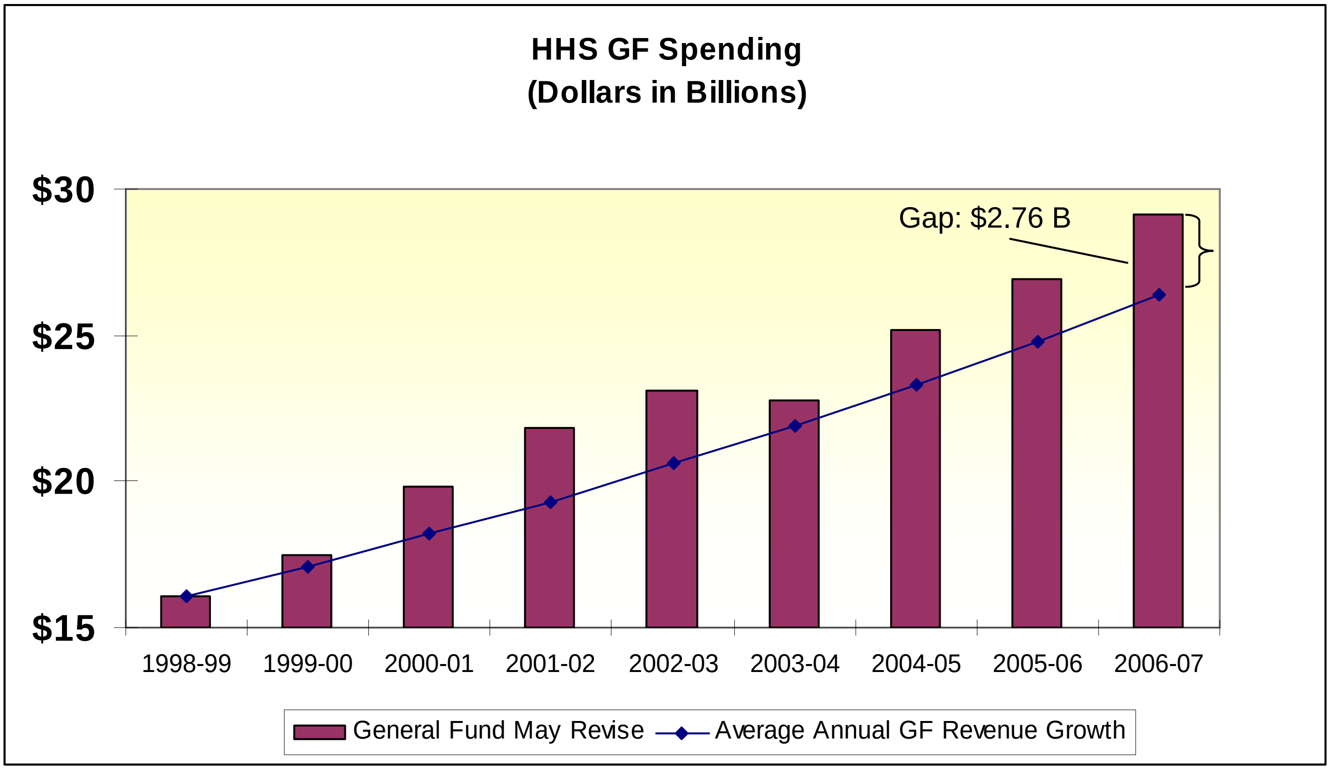
UC and CSU. The May Revision proposes to augment the budgets of UC and CSU by $1 million each in one-time funds for nursing programs. It contains no state funding for the Labor Institute, nor for "outreach."

Health and Human Services Overview

The May Revision proposes expenditures of $29.1 billion General Fund for all of Health and Human Services in 2006-07. This represents an increase of $2.3 billion or 8.5 percent above the revised 2005-06 level, and accounts for 29 percent of total General Fund expenditures. The proposed budget fails to set a sustainable level for program expenditures. ***The lack of major programmatic reforms to contain costs and reduce spending on these public***

health and welfare programs continues to be a serious threat to the state's fiscal health in both the short and long term.

Chart 1



Note: This chart reflects actual GF expenditures versus growth based upon the average annual GF revenue growth rate of 6.4 percent. The gap is $2.76 Billion in excess.

** The 2003-04 General Fund reflects one-time savings for accrual-to-cash accounting ($1 billion) and enhanced federal fiscal relief ($566.1 million) in the Medi-Cal program.*

Health

Department of Health Services

Medi-Cal. The Governor's May Revision includes $35 billion ($13.8 billion General Fund), which reflects an increase of $1.7 billion ($937.9 million General Fund) above the revised 2005-06 budget for Medi-Cal. However, this understates the expenditure growth because about $337 million General Fund that was budgeted in Medi-Cal has been shifted to the Department of Mental Health budget as a technical change. Therefore, a more accurate reflection of the expenditure increase is $1.3 billion, which is an increase of 9.1 percent. Notably, this cost growth comes on top of $1.1 billion General Fund (9.6 percent) growth between the 2004-05 and 2005-06 fiscal year. Put another way, ***Medi-Cal costs have grown by $2.4 billion General Fund over two years***.

This rate of growth exceeds the projections of a recent PPIC study that estimated Medi-Cal benefit expenditures will grow by about 8.5 percent annually over the next ten years. In 2010, the forecasts indicate that the total cost of the Medi-Cal program will rise to $53.9 billion ($19.7 billion General Fund). By 2015, these totals will rise to $79.6 billion, with $29.1 billion out of the

General Fund (equal to the combined cost of ***all*** Health and Human Services programs today). Overall population growth accounts for only about 17 percent of the projected increase in benefit expenditures. Looking at the numbers, it is hard to question the need to restructure the Medi-Cal program so that it will be viable in the future.

Medi-Cal Managed Care Plan Rates. The Medi-Cal managed care plans that serve half of all Medi-Cal beneficiaries (about 3.2 million – mostly women and children) get a reprieve as the five-percent rate reduction imposed as part of the 2003 Budget Act expires effective January 1, 2007. As a result, the May Revision includes $65.4 million ($32.7 million General Fund) to restore that earlier rate reduction.

More Medi-Cal Managed Rate Increases. In addition to the rate restoration noted above, the May Revision proposes an additional $61.2 million ($30.6 million General Fund) to further increase reimbursements for certain plans that have been determined worthy based on the results of a financial review conducted by the Department of Health Services. The plans receiving an increase are as follows: Central Coast Alliance for Health, Community Health Group, Contra Costa Health Plan, Health Plan of San Mateo, Partnership Health Plan of California, and Santa Barbara Regional Health Authority. This proposal seems very generous given that California still has a ***$7.1 billion operating deficit*** despite the significant increase in revenues. It is important to remember that California cannot reduce taxes or avoid a tax increase by increasing spending.

Federal Deficit Reduction Act (FDRA) Changes. The Administration has requested statutory changes that are necessary in order to receive federal funds for Medi-Cal beneficiaries. Essentially, it is now required that the Medi-Cal program verify citizenship at the time of initial application and for purposes of eligibility redeterminations. The individual would be required to show proof of identity and citizenship. No fiscal impact is assumed in the budget, but there could be higher county administrative costs for workload and there could be savings from reduced caseload. Clearly, it is very important California ensure that only those truly eligible receive benefits under this very costly welfare entitlement program.

Public Health

Fatal Contact: Bird Flu in America. A human pandemic caused by the “bird flu” (H5N1) is by no means inevitable. Many researchers doubt it will ever happen. The virus does not infect people easily, and those who do contract it almost never spread it to other humans. Bird Flu is what the name implies – an avian disease. It has infected tens of millions of birds but less than 200 people worldwide, and they all caught it from birds. However, the risk of a pandemic flu is present, and California ought to take reasonable steps to plan and prepare for such an event.

The Governor’s May Revision contains ***a massive $400 million General Fund proposal*** that is intended to “fill gaps” in the California health care system’s patient care capacity (i.e., ***surge capacity***). Generally, the proposal includes the following major components:

- **Provides $164.4 million to purchase supplies** (e.g., hospital beds and related equipment) for alternate care sites such as churches, schools, and hotels that may be converted to meet surge capacity needs in the event hospitals are overwhelmed. These items will also need to be stored and maintained for many years in the event a catastrophe does not occur.

- **Provides $99.8 million to buy about 7,183 hospital ventilators** that will also have to be stored and maintained for years.
- **Provides $53.3 million to purchase 3.7 million courses of antiviral** drugs that may or may not be effective on a mutated avian influenza virus.
- **Provides $50.5 million to buy about 528,000 masks** to provide respiratory protection to healthcare workers.
- **Provides $14.5 million for local health departments** who would be given funds to provide hospitals with permanent (non-state) staff to develop and maintain hospital surge plans that include plans for staffing, infection control, training and exercises. This will result in ***an ongoing annual state cost of $29 million General Fund*** for these hospital staff positions.
- **Provides $12.3 million to purchase two mobile field hospitals** and related equipment. This component is included in the **Emergency Medical Services Authority** (EMSA) budget.
- **Provides $5.2 million for development of state guidance and standards** for professional licensing flexibility among health facilities and the health care workforce, as well as issues surrounding liability protection, reimbursement for care givers, and training curricula.

This is a very large funding request considering the state's $7.1 billion operating deficit for fiscal year 2006-07. The proposal contains many complex and uncertain elements that will need to be thoroughly reviewed. Thoughtful consideration must be given to the cost in connection with the real and perceived risk, as well as an assessment of other existing state resources. In addition, the availability of resources from the federal government and international agencies that are also preparing for a major public health event should be considered as a potential source of assistance should such an emergency arise.

Office of Statewide Health Planning and Development

Hazards U.S. Seismic Safety Assessment (HAZUS). The May Revision includes $100,000 (fee-supported Special Funds) for an independent contractor to peer-review an analysis of the seismic safety risk of hospital buildings using the HAZUS. HAZUS is a federal seismic safety assessment tool that will be used to re-examine the risk of collapse for California hospitals in the event of an earthquake. It is likely that many hospitals will be shifted into lower risk categories as this new technology utilizes better data elements in determining risk levels, which means they will have more time to consider their seismic construction needs.

Fire and Life Safety Officer (FLSO) Training Program. In addition to implementing HAZUS, the May Revision includes $1.3 million (fee-supported Special Funds) for a proposal to establish a new training program for FLSO. The purpose of the training program is to improve the department's ability to respond to an increased volume of hospital construction projects that may arise as a result of current statutory requirements for hospital seismic compliance. Given the concerns raised over the past few years by the hospital industry about delays in the review and approval of construction plans, the establishment of a training program to expedite the plan review and approval process seems to have merit, especially since the industry is paying for it.

Managed Risk Medical Insurance Board

State Funding for County Health Initiatives. The Governor's May Revision requests $22.8 million General Fund, supposedly on a one-time basis, to provide grants to counties for the purpose of fully funding existing children's health initiatives (CHI). These CHIs have been established by counties utilizing their own funds (some use Tobacco Settlement Funds) to cover uninsured children in families with incomes below 300 percent of the federal poverty level, and in at least one instance 400 percent of the FPL. Three things should be clear: **1)** This is a proposal to use state General Fund to support a county responsibility and ***treat these county programs as though they were entitlement programs*** (i.e., no cap on enrollment or funding); **2)** The primary function of these programs is to provide ***public health insurance for undocumented immigrants***; **3)** Despite the Administration's "one-time funding" claim, ***this will become another ongoing, state-only, welfare program***.

Department of Mental Health

Restructure AB 3632 Mandate (Services to Handicapped and SED Pupils). The Federal Individuals with Disabilities Education Act (IDEA) requires states to guarantee disabled students the right to receive a free and appropriate public education that emphasizes special education and related services, which may include mental health services. This federal requirement on the state and local education agencies is ***a federal mandate***. However, state legislation enacted in the mid-1980s (AB 3632) shifted the responsibility for mental health-related services to special education students from schools to counties, and thereby ***created a reimbursable state mandate*** for which reimbursement claims exceed $140 million per year.

The May Revision provides $69 million General Fund to establish a new categorical program that is intended to replace the existing state mandate, which would be suspended via statutory changes. The funds would be allocated to county mental health agencies and utilized as match to draw the available federal IDEA funds for AB 3632 services. Consistent with current practice, an additional $100 million will continue to be provided to county mental health for AB 3632 services through county offices of education.

In addition to suspending the state mandate and establishing a new categorical program in its place, the Administration seeks $275,000 for 3.0 additional staff to increase monitoring and compliance activities. In general, this proposal appears to be moving in the right direction as ***the existing program lacks adequate incentives for counties and schools to provide necessary services in a cost-effective manner***. Under this new proposal, the Department of Education would be responsible for any costs that exceed the budgeted level.

Phase II for Chronic Homelessness Initiative. The May Revision requests an augmentation of $1.2 million Mental Health Services Act funds (Proposition 63) for 3.0 new state staff and related administrative support costs to implement what the Administration is calling Phase II of the Governor's Homelessness Initiative (GHI). Essentially, phase II of the GHI is to utilize up to ***$75 million per year from the continuously appropriated MHSA fund for the next twenty years*** to develop permanent supportive housing projects for individuals with mental illness and homeless children with serious emotional disturbances. It is anticipated that counties will submit 100 applications per year for these funds and that about 25 per year will be approved. This is a complex proposal that involves meeting certain legal requirements, and it may require long-term funding commitments from counties for supportive services using county realignment or county general funds.

Last year (2005-06) the May Revision included a proposal that utilized $2.4 million of MHSA (Proposition 63) funds for collaboration between the Health and Human Services Agency, and the Business, Transportation and Housing Agency. These funds are available for two years and were to be used ***primarily for rent subsidies***. In addition, $40 million was redirected from existing housing bonds and $10 million from the California Housing Finance Agency to create 400-500 units of permanent housing with services for the mentally ill. It is not yet clear what has been accomplished in Phase I of the GHI.

Human Services

Department of Social Services

CalWORKs. The May Revision provides $6.8 billion total funds (a 1.4-percent increase over the Governor's January Budget) for California Work Opportunity and Responsibility to Kids (CalWORKs) programs. Caseload is expected to be 475,100 in 2006-07, which represents 11,900 recipients or 2.5 percent *below* the January Budget.

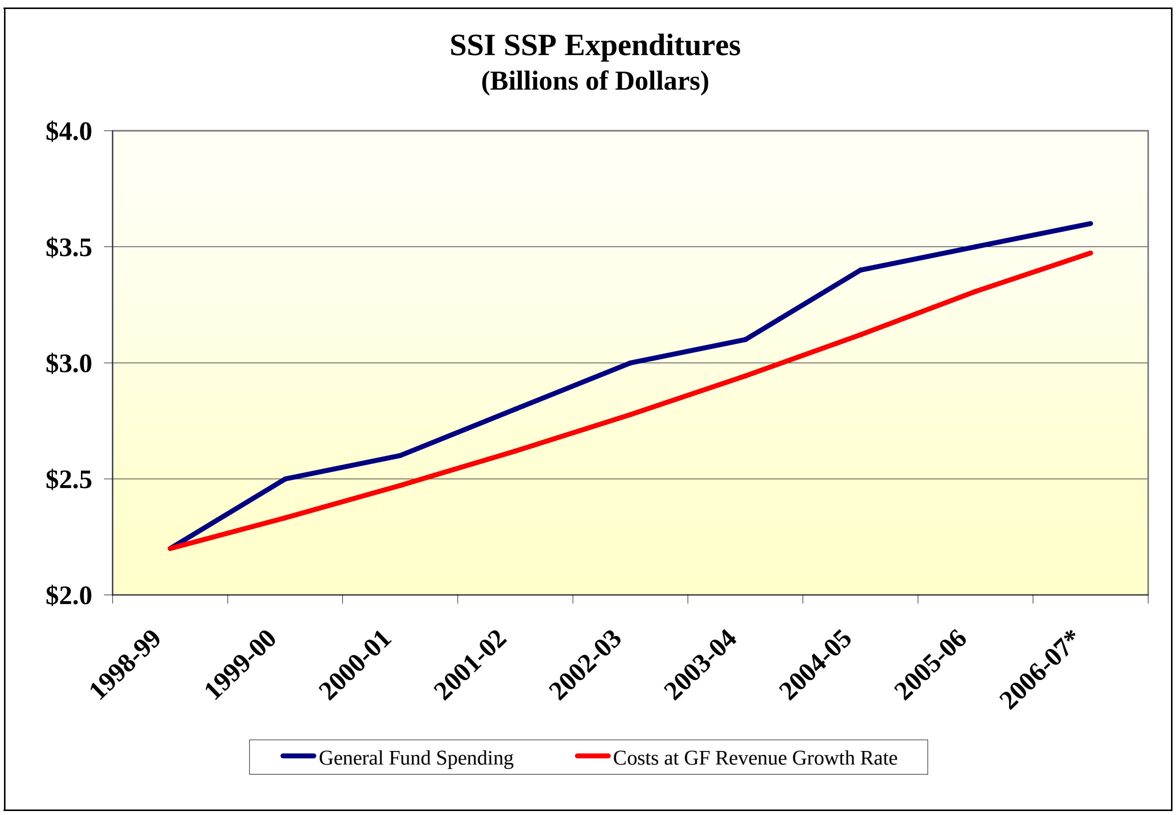
The federal Deficit Reduction Act of 2005 reauthorized the federal TANF program and updated the caseload reduction credit. As a result of the adjustment to the caseload reduction credit, California is not likely to meet federal targets and must improve work participation from the current rate of approximately 24 percent to 50 percent beginning October 1, 2006. Considerable improvement in work participation rates must be achieved to avoid federal penalties, which could be more than $2 billion General Fund over a five-year period.

- **Pay for Performance.** The May Revision sets aside $40 million in the 2006-07 CalWORKs reserve for the Pay for Performance program. Counties that successfully meet the desired outcomes would receive a fiscal reward in 2007-08.
- **CalWORKs Participation Improvement Project**. The May Revision includes $20 million in 2006-07 for the Participation Improvement Project to help counties overcome barriers in engaging CalWORKs recipients in appropriate activities and to improve counties' ability to meet the required work participation rate.
- **Performance Reviews and Best Practices.** The May Revision includes $1.5 million to implement a peer review program to identify best practices and obstacles to improved performance in individual counties. The Administration is uncertain how this money would be allocated to the counties and what program requirements, if any, would be necessary.
- **TANF Reauthorization/CalWORKs Reform Reserve.** In order to fund future program improvements that may be necessary in 2006-07, $114.6 million will be held in reserve.

Supplemental Security Income/State Supplementary Payment (SSI/SSP). The May Revision proposes $3.6 billion General Fund for SSI/SSP in 2006-07, an increase of $1.1 million General Fund above the Governor's January Budget. As is evident in the table below, SSI/SSP expenditures continue to exceed the costs that would be incurred at the average General Fund growth rate.

- **Rescind COLA Suspension.** The Administration has pulled back on the proposal to withhold the federal April 2007 SSI/SSP COLA. This savings proposal was not a structural reform proposal, but rather a one-time savings intended to see the state through a difficult revenue period. The May Revision proposes an increase of $43.8 million General Fund as a result of rescinding the proposal to suspend the pass-through provision of the April 2007 federal SSI COLA. Because of this action, monthly grant payment levels are estimated to be increased from $836 to $849 for aged or disabled individuals and from $1,472 to $1,491 for couples on April 1, 2007.
- **Lower Caseload.** A reduction of $25 million in 2005-06 and $21.6 million in 2006-07 due to lower caseload and lower average monthly grant expenditures since the Governor's Budget.
- **Savings Identified.** A decrease of $2.4 million in 2005-06 and $20.9 million in 2006-07 due to savings from performing more frequent eligibility redeterminations and changing the payment of retroactive benefits, as required by the federal Deficit Reduction Act of 2005.

Chart 2



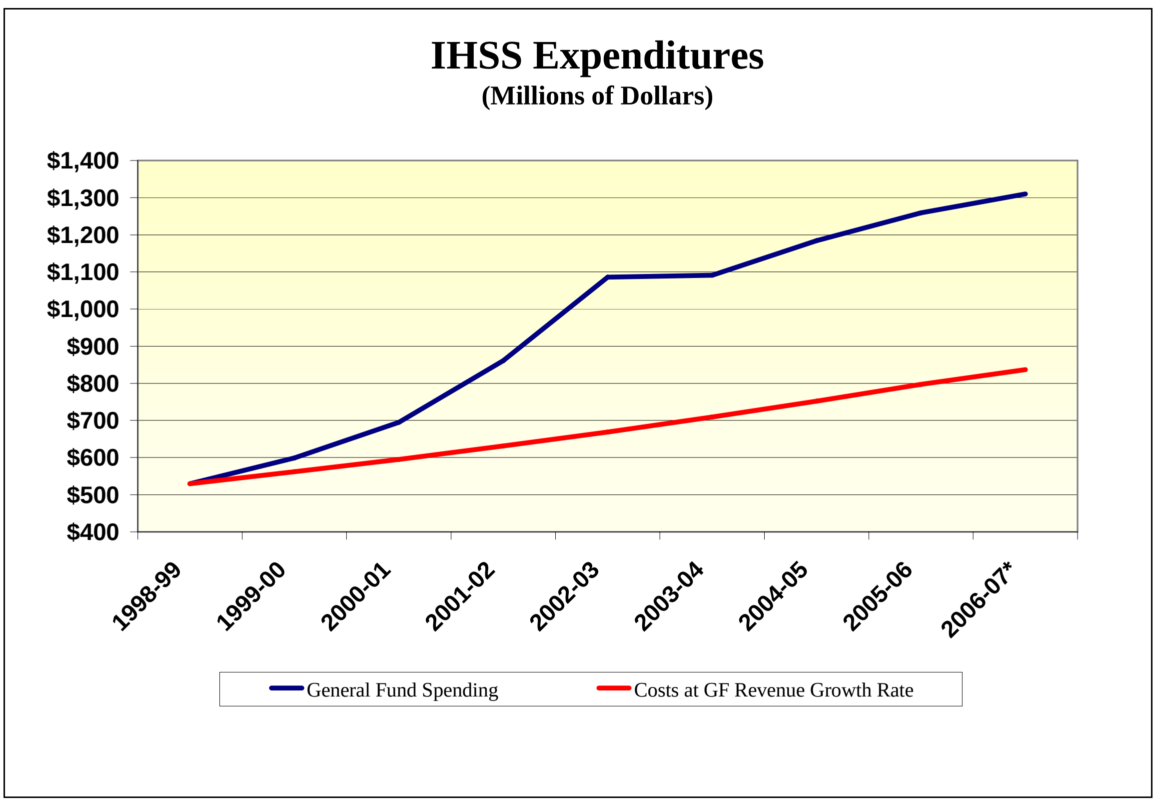
**As proposed in the Governor's May Revision*
Average annual General Fund expenditure growth from 1998-99 to 2006-07 of 7 percent
Average annual General Fund revenue growth from 1998-99 to 2006-07 of 6 percent

In-Home Supportive Services (IHSS). The May Revision proposes an increase of $22.4 million General Fund for the IHSS program in 2006-07 above the Governor's January Budget. The caseload is estimated to be 378,400 recipients in 2006-07, a decrease of 17,600 recipients from the Governor's January Budget.

The Governor's May Revision ***does not*** take any steps to stem the quickly rising costs of the IHSS program but in fact funds wage increases negotiated at the local level. ***Even with a reduction in caseload, program costs once again increase above the January Budget***, and as is evident in the chart below, continue to greatly exceed the costs that would be incurred at the state average General Fund growth rate.

- **Medi-Cal Share of Cost.** The May Revision includes an increase of $17.2 million in 2006-07 to continue funding costs associated with applying Medi-Cal share-of-cost rules to certain IHSS recipients.
- **Wage Increase.** The May Revision includes an increase of $18.6 million in 2006-07 for 15 counties that increased IHSS wages and/or health benefits since the January Governor's Budget.
- **Lower Caseload.** Lower IHSS caseload results in reduced expenditures of $11.7 million in 2006-07 since the January Governor's Budget.

Chart 3



**As proposed in the Governor's May Revision*
Average annual General Fund expenditure growth from 1998-99 to 2006-07 of 15 percent
Average annual General Fund revenue growth from 1998-99 to 2006-07 of 6 percent

Child Welfare Services (CWS). The May Revision includes expenditures of $645.3 million in 2006-07, an increase of $16.4 million compared to the Governor’s January Budget. The increase is due to policy changes and General Fund augmentations designed to improve outcome measure within the CWS arena. Caseload for all CWS programs is projected to decrease by 1.6 percent in 2006-07.

- **County Expansion of Program Improvement Plan.** The May Revision includes $19.6 million ($11.9 million General Fund) for county program improvement plan expansions. This funding will allow the Standardized Safety Assessment initiative to be expanded to an additional 18 counties and the Differential Response and Permanency Enhancements initiatives to be expanded to an additional 15 counties. Program expansion activities will assist the state in making progress toward federal compliance. Failure to demonstrate measurable improvement during the state's PIP evaluation, coming up in 2007, would result in significant federal penalties.
- **Dependency Drug Courts**. The May Revision includes $2.1 million General Fund to maintain expenditures for the Dependency Drug Court program and would provide contract funding for an evaluation of the cost-effectiveness of the existing pilot project. The cost-effectiveness of the program has been much touted but has not been validated by measurable data to date.

Foster Care. The May Revision includes expenditures of $1.6 billion ($418.1 million General Fund) for foster care in 2006-07, which represent a decrease of $8.7 million General Fund in 2006-07 compared to the January Governor's Budget. Caseload growth continues to slow and flatten, indicating reduced entries and increasing exits from the system. The year-to-year caseload growth is projected to increase by 0.4 percent.

- **Title IV-E Waiver**. The May Revision provides $35.5 million ($10 million General Fund) for costs to implement California’s Title IV-E Child Welfare Waiver Demonstration "Capped Allocation" Project, recently approved by the federal government. This waiver will test a "capped allocation" strategy that will provide federal Title IV-E foster care funds as block grants for up to 20 participating counties. The waiver will provide counties with maximum flexibility and allow them use of the funds to reduce out-of-home care, promote reunification, and address required state and federal outcomes for child safety, permanence, and well-being.

Transportation

Proposition 42 fully funded. Enacted by the voters in the March 2002 election, Proposition 42 amended the State Constitution to permanently dedicate sales taxes on gasoline for transportation projects. Specifically, the Proposition requires the transfer of gasoline sales tax revenues from the General Fund to a newly created Transportation Investment Fund (TIF). The Proposition also allows the Administration and the Legislature (if two-thirds of the membership approve) to suspend the transfer of sales tax revenues in a fiscal year in which the transfer will result in a significant negative impact on government functions funded by the General Fund.

The transfers were suspended in the first two years the Proposition 42 became effective. In fiscal year 2003-04, $868 million of the $1.157 billion in gasoline sales tax revenues was suspended. For 2004-05, the entire $1.243 billion was suspended, for a combined total of $2.1 billion. However, Proposition 42 is fully funded in 2005-06 at $1.3 billion. The May Revision proposes an increase of $13.6 million above the $1.406 billion in the 2006 Governor's Budget for a total of $1.419 billion in Proposition 42 funding, and allocates the funds pursuant to existing law as follows:

- $678 million to the Traffic Congestion Relief Fund
- $593 million to the State Transportation Investment Program
- $148 million to the Public Transportation Account

The May Revision reflects the Governor's January proposal to repay $920 million in 2006-07 on the 2004-05 Proposition 42 loan, reducing the Proposition 42 loan balance to $1.2 billion.

The table below displays the funding and suspension history of Proposition 42 since implementation in 2003-04.

Table 9

Proposition 42 Funds
(Dollars in Millions)

Fiscal year	Amount to be Transferred	Amount Suspended
2003-04	$1,157	$868
2004-05	1,243	1,243
2005-06	1,313	0
2006-07	1,419	0
Total	**$5,132**	**$2,111**

41% of Proposition 42 Funds Have Been Suspended

In total, $2.1 billion or approximately 41 percent of voter-approved Proposition 42 transportation funds have been retained in the General Fund and used for non-transportation purposes. The Governor's proposed restoration would reduce this percentage to 23 percent.

The May Revision also contains a proposal to allow for the transfer $185 million of TIF to the State Highway Account to fund Capital Outlay Support activities resulting from funding of Proposition 42. This would provide $185 million for projects in the State Highway Operation and Protection Plan (SHOPP).

Public Transportation Account (PTA) "Spill-Over" Funds. Current law contains an arcane formula that requires the General Fund to transfer sales tax revenues to the PTA under specified conditions. This transfer is often triggered during periods of high gasoline prices and is used to fund rail and mass transit projects. The May Revision proposes to shift these spill-over funds to a new fund, Transportation Debt Service Fund, which would be dedicated to paying a portion of the debt service on existing and new transportation bonds. The General

Fund will pay the remaining debt service. This proposal would, in effect, divert monies from public transit projects to repayment of debt service. Based on current forecasts, this could provide $4.1 billion through 2015-16.

Table 10

Spill-Over Funds Dedicated to Transportation Bond Debt (Dollars in Millions)	
2006-07	$355.1
2007-08	$336.3
2008-09	$422.8
2009-10	$700.4
2010-11	$820.5
2011-12	$356.0
2012-13	$333.9
2013-14	$308.2
2014-15	$279.2
2015-16	$247.8
Total	**$4,160.2**

Repayment of Transportation Loans from Tribal Gaming Bonds Delayed. Between fiscal years 2001-02 and 2004-05, the General Fund borrowed a total of $3.667 billion from transportation, including $1.556 billion in loans from various transportation accounts, and $2.111 billion from the 2003-04 and 2004-05 Proposition 42 suspensions.

For 2004-05, a total of $1.397 billion was proposed to be repaid from a variety of funding sources, authorized by both the 2004 Budget Act and AB 687 (Chapter 91, Statutes of 2004) related to tribal gaming compacts. Specifically, the Budget Act authorizes repayment of $183 million from a combination of General Fund and Public Transportation Account "spill-over" revenues. Also, AB 687) proposes to repay $1.214 billion from bond proceeds secured by tribal gaming revenues.

The 2005 Budget Act assumes that the bonds will be sold in the spring of 2006. An April Finance Letter proposed to shift $849 million of the $1.0 billion in tribal gaming expenditure authority from 2005-06 to 2006-07 to reflect the delay in receiving these revenues. Presently, the timing for the sale of bonds is still uncertain due to litigation that has been filed against the state.

Capital Outlay Support Staffing. The May Revision proposes to decrease the capital outlay support program for project delivery activities, including 226 positions, overtime, and contract funding totaling $39.3 million. This will reduce workload to the current year level based on a re-evaluation of workload tied to the delivery of programmed projects for the State Transportation Investment Program (STIP) and SHOPP. Of these savings, $12.2 million is proposed to be redirected to increase the tort claims budget to the average amount spent in recent years, which has been approximately $54 million.

Redirection of Funding from the Capital Outlay Support Stormwater Program to the Maintenance Program. The May Revision proposes a permanent transfer of $8.1 million in storm water funds from the Capital Outlay Support Program to the Maintenance Program for litter pick up, $5 million, and Bridge Paint Containment, $3.1 million.

The reason for the savings in the Storm Water Program is unclear and the proposal to use these savings for litter pick up seems inappropriate given the need for transportation projects.

Transit Funding. The May Revision reflects an increase of $35 million in grants for local transit operations to a level of $270 million. Revenues from the sales tax on diesel fuel, Tribal Gaming Bonds proceeds, and Proposition 42 have resulted in a projected balance exceeding $500 million at the end of 2006-07, which is available for capital projects. State support for transit operations has increased by $153 million over the 2004-05 level.

Department of Motor Vehicles - Implementation of Real ID Act. The May Revision proposes $18.8 million from the Motor Vehicle Account and 36.4 positions to begin the planning, programming and infrastructure development necessary to implement the federal Real ID Act. The Act sets minimum standards for information and security features on each driver license and identification card and establishes strict criteria for documents acceptable for proof of identity. The new driver's license and identification cards will be needed to access federal facilities, boarding federally regulated commercial aircraft, and other purposes determined by the Secretary of Homeland Security. The request would establish an organizational unit dedicated to Real ID that would be responsible for overall project and policy development. DMV would also implement a web-based infrastructure that would transfer 2.2 million transactions annually out of the field offices to free up space for individuals applying for Real IDs.

A concern with this proposal is that federal regulations relating to the implementation of the Act are still pending; however, the Act must be implemented by May 11, 2008. DMV has indicated that the work associated with this May Revision request would not be adversely impacted should federal regulations change components of the Act.

Resources

State Flood Control Subvention Program. Existing law regulates state participation in federal flood control projects, and state authorization is required before a local government project sponsor may receive reimbursement from the state for its share of the project costs. The federal government pays a maximum of 65 percent of the project costs. State law requires that of the remaining non-federal share of the total project costs, the state pays 50 percent and the local government pay 50 percent, unless the project meets specific criteria, in which the state can increase the cost share up to 70 percent (AB 1147, Chapter 1071, Statues of 2000). For projects authorized before January 1, 2002, the state share for the project costs is 70 percent and the local agency is 30 percent.

Currently, the state has approximately $168 million in claims from local governments for state authorized flood control projects. The amount is estimated to increase to $250 million by the end of the 2005-06 fiscal year. The overall state share for these projects is estimated at $655 million. The May Revision proposes $100 million in General Fund towards the payment of current claims in the order the claims have been received.

It should be noted that this proposal ***gives priority to the Napa County Flood Control and Water Conservation District*** to process $10 million in claims putting this county ahead of others. The priority shall apply to 2006-07 in recognition of extensive flood damage that occurred in January 2006.

Reorganization of the CALFED Bay-Delta Authority. CALFED is a consortium of state and federal agencies created to address various inter-related water problems in the Bay-Delta region over the next 30 years. CALFED goals include improving water quality and wildlife habitat, increasing water supply, and reducing flood risks from levees. However, since CALFED began implementing programs and project construction in 2000, federal funding commitments have fallen short.

In January 2005, the Governor's budget included program and fiscal reviews by the Department of Finance, the Little Hoover Commission, and an independent consulting firm to evaluate the program and make recommendations for improvement. In April, a Finance Letter was submitted to address the recommendations provided by the reviewing entities and proposed to shift $31 million and 68 positions budgeted in the Bay-Delta Authority to the Secretary of Resources to provide visibility, accountability, and decision-making authority to the CALFED administrative function. It was unclear how this proposal would provide better management and oversight of the CALFED program and address the concerns of water users who would prefer a scaled-back plan to reduce taxes and fees. ***The proposal also provided no assurance to protect water users from future water loss or financial outlays for habitat restoration projects, and little increase in federal funding.***

This request was rejected by the subcommittee and instead the subcommittee recommended a transfer of 3 positions to the Secretary of Resources and dispersing of the remaining positions to the Department of Water Resources, Department of Fish and Game, and the Department of Health Services. ***This proposal has concerned water providers as they feel that it puts too much power into departments without enough oversight***.

The May Revision includes a proposal to consolidate the Ecosystem Restoration Program within the Department of Fish and Game by establishing 10 positions and increase reimbursements and Propositions 50 bond funds to implement a component of the Governor's 10-Year CALFED Action Plan.

Fish and Game Preservation Fund. The Governor's May Revision proposes the transfer of $19.9 million from the General Fund to the Fish and Game Preservation Fund to bring all of the subaccounts within the fund into balance and eliminate long running deficits. These funds are needed to avoid closures of commercial and recreational fishing, closure of wildlife areas, reductions in environmental reviews, and reductions in sport fishing opportunities. To the extent that the Department of Fish and Game has been unable to provide a report requested in 2005 Supplement Report Language to sufficiently detail the level of activities being performed by the department and the funding dedicated to each activity, it appears premature to provide funding at this time.

Additional One-time Funding. The May Revision proposes an additional $50 million in General Fund for the following activities:

- $10 million for salmon and steelhead restoration.
- $10 million for marine life and marine reserve management.
- $10 million for non-game fish and wildlife programs.
- $10 million for deferred maintenance in state parks.
- $5 million for wetland and riparian habitat conservation.
- $5 million, from which the interest only would be expended for management of coastal wetlands.

Local Government

Tax Relief. The May Revision proposes a net increase of $7.8 million General Fund above the Governor's Budget for Senior Citizen tax assistance programs, including:

- $6.0 million increase in the Senior Citizens' Renters' Assistance Program. This increase offsets the $5.5 million decrease included in the Governor's Budget.
- $2.1 million increase to reflect the receipt of revised participation calculations for the Senior Citizens' Property Tax Deferral Program. This increase is in addition to the $900,000 increase included in the Governor's Budget.
- $420,000 decrease in the Senior Citizens' Property Tax Assistance Program. This decrease is in addition to the $1.9 million decrease included in the Governor's Budget.

In total, 2006-07 General Fund expenditures for these programs are up by a net $1.2 million.

General Government

Secretary for Business Transportation and Housing. The May Revision proposes a total of $5 million General Fund for the San Joaquin Valley Strategic Action Proposal. It would provide $2.5 million to implement the proposal and $2.5 million local assistance to provide Action Proposal implementation grants. This proposal supports the Governor's Executive Order S-5-05 to improve the economic well-being and quality of life in the eight counties that comprise the San Joaquin Valley Region.

State Mandates. The May Revision proposes a net increase of $26.1 million General Fund and revised expenditures included in the Governor's Budget to address various state mandate reimbursement issues, as follows:

- $86.9 million ***increase*** to pay the 2007-08 mandate debt repayment in advance of the required timeline.
- $50 million ***decrease*** to reflect the transfer of funding for services provided under AB 3632. This funding is being transferred to the Department of Mental Health.
- $15.1 million ***decrease*** related to the first year of the 15-year repayment of past mandate debt, based on updated claims information.
- $4.1 million ***increase***, and revised expenditure classifications, to fund the 2005-06 estimated claims obligations for specified mandates.

- $270,000 ***increase*** to contract with a facilitator that will lead discussions to reform the state mandate reimbursement process.

Statewide Issues

Augmentation for Employee Compensation. The May Revision includes funding for salary increases required under current contractual obligations for a number of bargaining units, including attorneys, highway patrol, correctional peace officers, safety employees, and engineers. Overall, the May Revision includes an increase of $81 million General Fund as a result of a higher than estimated salary increase for Bargaining Units 5 and 6 (Highway Patrol and Correctional Peace Officers), and health care contributions for two recently signed agreements. There are still 17 bargaining units with expired contracts. The Administration intends to fund these future agreements from the General Fund reserve should agreements be successfully negotiated in 2006-07.

- **Plata v. Schwarzenegger.** The Plata court order required the state to provide compensation increases to health care staff in the Department of Corrections and Rehabilitation (DCR). The Governor's Budget included $56.8 million General Fund for these DCR costs, plus funding for pay raises within the Department of Mental Health (DMH). The May Revision requests an additional $25.2 million General Fund to fully fund DMH's cost for the Plata recruitment and retention differentials.

  This request is disconcerting as the state is ***not required*** to increase compensation levels for health care staff within DMH and extending a court order beyond the scope of the requirement not only ***sets a bad precedent***, it will result in the state spending tens of millions of dollars more than required to meet the terms of the order.

State Teachers' Retirement System. The May Revision includes a reduction of $121.5 million General Fund due to an accounting error recently discovered in the CalSTRS' accounting system. The state was paying more in 2002-03, 2004-05, and 2005-06 than is required by law. This large of an accounting error leads to a general concern with the oversight of this program: is the state providing sufficient oversight of accounting practices for a program that is funded with nearly $1 billion General Fund annually?

State Appropriations Limit Calculation. Pursuant to Article XIIIB of the California Constitution, the 2006-07 State Appropriations Limit (SAL) is estimated to be $72.303 billion. The revised limit is the result of applying the growth factor of 4.96 percent. The revised 2006-07 limit is $175 million above the $72.128 billion estimated in January. The SAL for 2005-06 does not change since it was statutorily established by Control Section 12.00 of the 2005 Budget Act.

Public Safety and Judiciary

Department of Justice. The May Revision includes an increase of $2 million General Fund for continued implementation of the Proposition 69 DNA program within the Bureau of Forensic Services. Proposition 69 proposed that funding be provided through an increase in fines, but this program has become largely a General Fund program because of revenue shortfalls. ***The Administration has not proposed any fine increases to cover the shortfall.***

Public Safety. The May Revision includes $142 million to fund public safety proposals including:

- **$50 million for Mentally Ill Offender Crime Reduction (MIOCR**) grants to provide funding to mental health initiatives in local law enforcement. These grants were originally authorized in 1998, before the passage of Proposition 63 which will provide $655 million in 2006-07 for local mental health programs.
- **$42.6 million to restore the Citizens' Option for Public Safety (COPS) and Juvenile Justice Crime Prevention Act grants** to 2000-01 funding levels of $121.3 million each.
- **$20 million for the California Multi-jurisdictional Methamphetamine Enforcement Team (Cal-MMET)** program to restore funding to 2001-02 levels. This proposal would provide funds to all four High-Intensity Drug Trafficking Areas, and increase funding for Central California.
- **$19.5 million to restore funding in the Corrections Training Fund** to restore a redirection in 2003-04. At that time the amount redirected was $16.8 million. This funding is used to partially compensate local law enforcement for the costs of providing training for local adult and juvenile correctional and probation staff.
- **$10.1 million to restore Vertical Prosecution Block Grants** to historical funding levels of $18.3 million. Funded programs include: Career Criminal Prosecution (CCP), Child Abuser Vertical Prosecution (CAVP) Elder Abuse Vertical Prosecution (EAVP), Major Narcotic Vendors Prosecution (MNVP), and Statutory Rape Vertical Prosecution (SRVP).

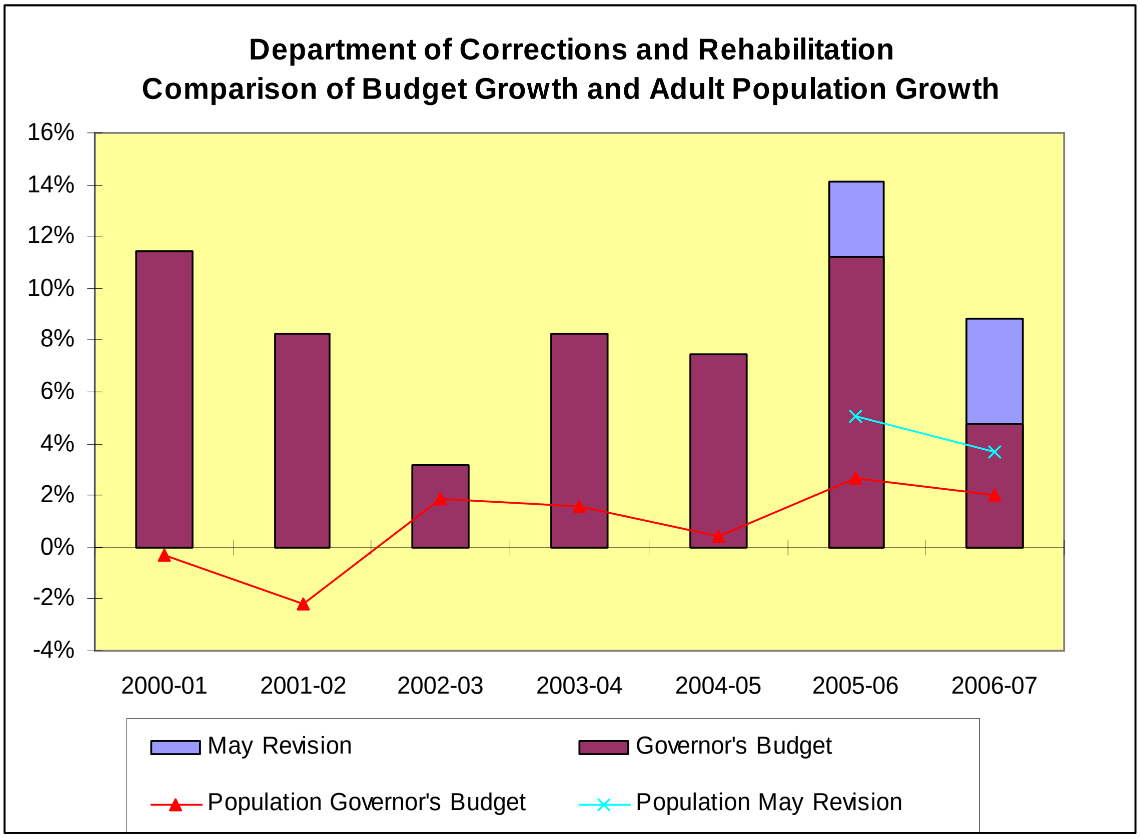
Booking Fee Subventions. The May Revision proposes to eliminate booking fee subventions and replace them with the ***Local Detention Facility Fund***, at the same funding level of $40 million. The proposal would eliminate booking fees, and instead replace them with a Jail Access Fee that would only be charged if an entity exceeded certain averages for booking low level offenders. The funding will be converted to a Local Detention Facility Fund and would be used for the operation, renovation, remodel, reconstruction, or new construction of local detention facilities in each county, and the funding would be continuously appropriated.

Department of Corrections and Rehabilitation. The May Revision proposes a net increase of $45.9 million General Fund for the current year and $223.8 million General Fund ($4.2 million Proposition 98 General Fund) for the budget year. This is in addition to a net increase of $57.5 million General Fund for the budget year proposed in the April 1 finance letter, and proposed net increases of $228.7 million ($6.1 million Proposition 98 General Fund) for the budget year contained in an April 20 Finance Letter related to court issues. The Department has also submitted current year funding requests for $151.1 million since the Governor's

Budget. ***This is a total increase for 2006-07 of $510 million*** or 6.5 percent from the Governor's Budget.

As has been the trend for the past several years, and as indicated in the table below, budget growth far exceeds population growth, and given funding pressures in the Department this is likely to continue.

Chart 4



"Population" Related Increases

The May Revision includes a net increase of $43.7 million in the current year and $144.3 million in the budget year for adult population growth. ***However, these increases are not strictly associated with population growth*.** For example, the Division of Juvenile Justice budget increases despite continued declining population. The May Revision proposes an increase of $2.1 million for the current year and $7.3 million for budget year for juvenile population issues. The May Revision also proposes an increase of $427,000 in 2005-06 and $3.4 million in 2006-07 for the Board of Parole Hearings, largely related to compliance with the Valdivia remedial plan.

The estimated current year institution Average Daily Population (ADP) is 168,008, an increase of 1,680, and a parole ADP of 115,290, a decrease of 234 from the Governor's Budget. The estimated budget year institution ADP is 175,627, an increase of 5,422, and a parole ADP of 117,754, an increase of 1,534 over the Governor's Budget. The budget year increase is based upon an increase in new admissions from court, parole violators with new terms, and parole violators returned to custody. The budget year population proposals far exceed nominal capacity for the Department. The population proposal includes $1.2 million in the current year and $11.4 million in the budget year for Population Management issues. However, the Department has not submitted a clear outline of long range plans to address population increases. The new management team of the Department has committed to completing a comprehensive population management plan within 45 days.

The Youth Authority population continues a downward trend and reflects an estimated 2006-07 year-end ward population of 2,660, a decrease of 20 wards from the number projected in the Governor's Budget. The parole population is estimated to be 2,935, a decrease of 240 from the Governor's Budget.

Inmate Health Care

The May Revision proposes to create a standalone budget item for inmate health care. This is in response to the recent takeover of the CDCR health care system by a receiver appointed by the Federal Court. The Budget Proposes transferring $1.4 billion General Fund from the Department's main item, and also schedules an additional $65.2 million from the main item for inmate health care. The item contains provisional language allowing the Director of Finance to augment the appropriation by up to $250 million resulting from the actions of the receiver or the court in the *Plata v. Schwarzenegger* litigation, and allowing the augmentation to be transferred to any item in the budget. **The budget does not contain any offsets to account for potential costs from the receiver, and it is likely that there will be significant costs in the budget year.** The May Revision and prior Finance Letters make several augmentations to health care. From the April 20 letter they include:

- $182.4 million for increased costs for medical contracts and medical guarding.
- $20.2 million for mental health staff to implement the requirements of court orders related to the *Coleman v. Schwarzenegger* litigation.
- $6.9 million for headquarters staff to meet the requirements of various court orders.
- $5.8 million for supervisory dental staff to meet the requirements of *Perez v. Hickman.*
- $1.3 million for court compliance related to death reviews, review of professional practices, and the employee discipline process.

The May Revision includes funding for the following health care issues:

- $15 million for pay enhancements for mental health staff both in the field and in headquarters as a result of court orders in the *Coleman v. Schwarzenegger* litigation.
- The population proposal includes $12.2 million for activations ordered by the *Coleman and Plata* courts.

Health Care issues also are driving significant costs for Capital Outlay for CDCR including $38.5 million to begin the process for several proposals to increase capacity for mental health beds to respond to concerns of the court in the *Coleman* litigation. The total costs of these projects exceed $600 million and will be completed in 2010-11.

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